USA (20)

No. 06-484

FILED
MAR 5 - 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The
Supreme Court of the United States

TELLABS, INCORPORATED AND
RICHARD C. NOTEBAERT,

Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., *ET AL.*,

Respondents.

**On Writ Of Certiorari To The
United States Court Of Appeals
For The Seventh Circuit**

BRIEF FOR *AMICI CURIAE* NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS AND NATIONAL ASSOCIATION OF SHAREHOLDER AND CONSUMER ATTORNEYS IN SUPPORT OF RESPONDENTS

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I. INTERESTS OF THE *AMICI CURIAE*[1]

The National Conference on Public Employee Retirement Systems ("NCPERS") is the largest national, nonprofit public pension trade association, with a membership that includes over 500 pension funds representing nearly $3 trillion in assets. Since 1941, NCPERS has worked to protect the pensions of public employees. Because of NCPERS' interest in preserving retirement benefits for public employees, it is very concerned about fraudulent practices in the securities industry and the nation's capital markets. NCPERS recognizes the need to combat securities fraud and restrain corporate excess, and appreciates the role of private securities actions in providing a means to deter corporate wrongdoing and compensate victims of securities fraud.

The National Association of Shareholder and Consumer Attorneys ("NASCAT") is a nonprofit membership organization founded in 1988. NASCAT's member law firms represent investors (both institutions and individuals) in securities fraud and shareholder derivative cases throughout the United States. NASCAT and its members are devoted to representing victims of corporate abuse, fraudulent schemes, and so-called "white collar" criminal activity in cases that have the potential for advancing the state of the law, educating the public, modifying corporate behavior, and improving access to justice and compensation for the wrongs inflicted upon victims. NASCAT advocates the principled interpretation and application of the federal securities laws – including the Securities Act of 1933 (the "1933 Act"), the Securities Exchange Act of 1934 (the "1934 Act"), and the Private Securities Litigation Reform Act of 1995 (the "PSLRA") – to protect investors from manipulative, deceptive and fraudulent practices,

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[1] In accordance with Rule 37.6, counsel for NCPERS and NASCAT represent that they authored this brief in whole and that no person other than the *amici curiae*, their members or their counsel made a monetary contribution to its preparation or submission. Petitioners and Respondents have consented to the filing of this brief.

and to ensure that the nation's capital markets operate fairly and efficiently. NASCAT has previously filed *amicus curiae* briefs in this Court in cases involving the construction and application of the federal securities laws.[2]

II. INTRODUCTION

This case concerns the "strong inference" requirement for pleading scienter imposed on private securities fraud complaints seeking to recover damages under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC"). For the reasons stated above, NCPERS and NASCAT are qualified to advise this Court, as *amici curiae*, of the meaning and import of Section 21D(b)(2) of the PSLRA, which imposed the "strong inference" requirement for pleading the scienter element of Section 10(b)/Rule 10b-5 claims, as applied by the Courts of Appeals since the PSLRA's passage. NCPERS and NASCAT believe that when this Court examines the relevant statutory language and the well-settled jurisprudence concerning the interpretation of Federal Rule of Civil Procedure 9(b), which Section 21D(b)(2) was intended to supplement as to private securities fraud complaints, it will agree that the Seventh Circuit's holding was correct and that Section 21D(b)(2) does ***not*** require the weighing of competing inferences. Further, NCPERS and NASCAT believe that the Seventh Circuit's opinion is consistent with the important public policies underlying private enforcement of the federal securities laws, and that affirming the decision of the court below will further the goals of deterring securities fraud, engendering public trust in the capital markets, and protecting victims

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[2] *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503 (2006) (NASCAT-AARP); *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005) (AARP-NASCAT-Consumer Federation of America); *S.E.C. v. Zandford*, 535 U.S. 813 (2002) (AARP-NASCAT); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (NASCAT); *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286 (1993) (NASCAT).

of investment fraud, so that they may obtain adequate recovery for their losses.

NCPERS and NASCAT submit that any reasoned analysis of Section 21D(b)(2)'s "strong inference" requirement cannot be viewed in isolation but, rather, must take into account the remarkable instances of breaches of fiduciary duty, failed audits, and corporate scandals that have infected this nation's capital markets almost from the date of passage of the PSLRA. Financial scandals at Enron, WorldCom, Tyco International, Global Crossing, Adelphia Communications, and others have cost shareholders staggering amounts of money. The more recent scandals regarding "market timing" of mutual funds and the back-dating of options to swell the earnings of already well-compensated corporate executives have done nothing to shore up the confidence of the average shareholder or mutual fund investor but, rather, have undermined the faith of investors in our capital markets.

When Congress enacted the PSLRA, it recognized that private securities actions are "an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action" and that such litigation "promote[s] public and global confidence in our capital markets and help[s] to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers, and others properly perform their jobs." H.R. CONF. REP. NO. 104-369 ("H.R. CONF. REP."), at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731. This Court has likewise acknowledged on numerous occasions the salutary purposes of the private right of action for securities fraud as an augment to the SEC's regulatory enforcement activities. *See, e.g., Dura*, 544 U.S. at 345 (observing that "the availability of private securities fraud actions" acts to deter fraud and thereby assist in maintaining "public confidence in the [securities] marketplace"); *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986) (cautioning against any impairment of "the deterrent value of private rights of action" under the securities laws); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (emphasizing that "implied private actions provide

'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to [SEC] action'") (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)). *See also Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (the private right of action "constitutes an essential tool for enforcement of the 1934 Act's requirements") (citations omitted); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983) (observing that "the interests of plaintiffs in [private securities fraud cases] are significant [and since] [d]efrauded investors are among the very individuals Congress sought to protect in the securities laws[,] [i]f they prove that it is more likely than not that they were defrauded, they should recover.").

Petitioners and their *amici* ignore these important public policies, argue as if the restrictions imposed by the PSLRA and significant amendments to the Federal Rules of Civil Procedure have not had a profound effect on how private securities actions are litigated, and ask this Court to impose yet another procedural hurdle – this one nearly insurmountable – on the ability of private investors to deter corporate wrongdoing and recoup some of their losses. This Court should decline the invitation and should affirm and endorse the decision of the court below.

III. SUMMARY OF ARGUMENT

The question presented by this appeal is narrow and, as Petitioners and their *amici* consciously choose to ignore, ***only*** arises when a securities fraud complaint has satisfied the heightened pleading requirement for scienter imposed by Section 21D(b)(2), added to the 1934 Act by the PSLRA, and codified at 15 U.S.C. § 78u-4(b)(2). As recognized by the Seventh Circuit, a court need not engage in an exercise of counterbalancing "strong inferences" of scienter with so-called "innocent inferences" because the mandate of Section 21D(b)(2) is satisfied once a "strong inference" of scienter has been established. For a court to search the face of the pleadings to identify supposed "innocent inferences" of scienter to offset alleged "strong inferences" exceeds the PSLRA's heightened pleading

requirements and contravenes a securities fraud plaintiff's Seventh Amendment rights. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602 (7th Cir. 2006) ("Faced with two seemingly equally strong inferences, one favoring the plaintiff and one favoring the defendant, it is inappropriate for us to make a determination as to which inference will ultimately prevail, lest we invade the traditional role of the fact finder") (quoting *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1188 (10th Cir. 2003)).

The stated purpose of Section 21D(b)(2) is to "establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits." Although the imposition of "stringent pleading requirements" has reduced the number of securities fraud suits being filed, the goal of uniformity has yet to be achieved. Rather, the PSLRA pleading requirements have spawned two significant splits among the Courts of Appeals (presenting yet another similarity with Rule 9(d), which Section 21D(b)(2) was supposed to replace): the first over the manner in which allegations sufficient to give rise to a "strong inference" of scienter may be pleaded, and the second – directly implicated in this appeal – regarding whether a plaintiff must be afforded the traditional deference on a Rule 12(b)(6) motion to dismiss once a "strong inference" of scienter has been adequately alleged.

Petitioners' arguments disregard the well-established judicial principle that all pleadings must be construed in a light most favorable to plaintiffs, and this Court's directive that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). Further, as the lower federal courts have reaffirmed in the securities fraud context, all reasonable inferences that can be drawn from the face of the pleadings should be drawn in plaintiff's favor. *In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 193 n.2 (1st Cir. 2005) ("We are skeptical of this reading of the Complaint, especially given the obligation to construe the Complaint in the light most favorable to plaintiffs."); *No. 84*

Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp., 320 F.3d 920, 946 (9th Cir.), *cert. denied*, 540 U.S. 966 (2003) ("In this era of corporate scandal, when insiders manipulate the market with the complicity of lawyers and accountants, we are cautious not to raise the bar of the PSLRA any higher than that which is required under its mandates. The District Court's failure to accept Plaintiffs' allegations as true and construe them in the light most favorable to Plaintiffs does just that"); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) (*en banc*), *cert. dismissed*, 536 U.S. 935 (2002) ("Our willingness to draw inferences in favor of the plaintiff remains unchanged by the PSLRA ... [which] would hardly serve its purpose to protect investors and to maintain confidence in the securities markets ... were it to become a choke-point for meritorious claims") (citations and internal quotations omitted).

Any consideration of possible "innocent inferences" at the pleading stage will inevitably result in defendants raising even the most tenuous but supposed innocent inferences and thereby turn the pleading stage into a mini-trial on the merits of the allegations, when plaintiffs have not been afforded the benefit of any formal discovery. Defendants will seize on the established principle that, when ruling on a motion to dismiss, a trial court may properly consider, *inter alia*, documents referenced in a complaint though not attached, so long as neither party questions the authenticity of those documents, documents that are integral to a plaintiff's claim but not explicitly incorporated in the complaint, or matters that are properly the subject of judicial notice. Unlike any other area of litigation, securities fraud defendants will be in the extraordinary position to self-select from their library of documents support for supposed "innocent inferences" that can be drawn from the pleadings, at a stage when plaintiffs are prohibited from serving a single discovery request.

The PSLRA's heightened pleading requirement is satisfied when the allegations in a securities fraud complaint support a strong inference of scienter. To the extent

a defendant is able to establish a competing inference for purposes of a motion to dismiss, that inference should ***not*** be considered by a district court at that time but, rather, should be the subject of discovery and, possibly, a motion for summary judgment. Such an approach fulfills the mandate of the PSLRA by permitting meritorious claims to proceed to discovery, and keeps inviolate a party's constitutional right to a trial by jury. Contrary to the rhetoric of Petitioners and their *amici*, the stated goal of the PSLRA is to avoid vexatious, lawyer-driven litigation. The heightened pleading requirement is only one arrow in a corporate defendant's quiver. The goal to eradicate lawyer-driven litigation is being aptly fulfilled through the PSLRA's "lead plaintiff" provisions, which encourage large and sophisticated institutional investors to control the litigation – not class action lawyers. The PSLRA's discovery stay also prevents so-called "fishing expeditions" by staying discovery until after the district court first determines that the applicable pleading requirements have been met. As a result, since 1996 the number of private securities actions filed have steadily declined and the percentage of securities fraud complaints dismissed on a Rule 12(b)(6) motion has increased.

IV. ARGUMENT

A. THE PSLRA PLEADING REQUIRMENTS WERE INTENDED TO DISPOSE OF FRIVOLOUS ACTIONS, NOT MERITORIOUS CLAIMS.

The PSLRA's "required state of mind" requirement for complaints alleging securities fraud provides that:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u-4(b)(2).[3] This provision is one of two pleading "requirements" imposed by the PSLRA that, if not met, mandate the trial court's dismissal of the complaint. 15 U.S.C. § 78u-4(b)(3)(A).

The stated purpose for Section 21D(b)(2) was "to curtail the filing of meritless lawsuits." H.R. CONF. REP., at 41; S. REP. NO. 104-98 ("S. REP."), at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694 (same). In this respect, Section 21D(b)(2) was similar to Rule 9(b)[4] and, at the time the PSLRA was enacted, the standard for compliance with Rule 9(b) used by courts in the Second Circuit was considered the most rigorous. *See* S. REP., at 15 (referring to Second Circuit precedent as "the most stringent pleading standard"); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 407 (5th Cir. 2001) (same).

Developed to, *inter alia*, "minimize the number of strike suits," *see Segal v. Gordon*, 467 F.2d 602, 607 (2d Cir. 1972), Second Circuit caselaw recognized that, pursuant to Rule 9(b), "malice, intent, knowledge, and other condition of mind" could be "averred generally" because "it would be unworkable and unfair to require great specificity in pleading scienter." *See Stern v. Leucadia Nat'l Corp.*, 844 F.2d 997, 1004 (2d Cir.), *cert. denied*, 488 U.S. 852 (1988) ("[A] plaintiff realistically cannot be expected to plead a defendant's actual state of mind") (citation omitted). Nevertheless, it was required that the "circumstances must be pleaded that provide a factual foundation for otherwise conclusory allegations of scienter." *Id.* (citations

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[3] "Securities fraud" refers to a cause of action based on Section 10(b) of the 1934 Act, 15 U.S.C. § 78j, and/or SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. The "required state of mind" for an action for securities fraud is "scienter." *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding that no "private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of 'scienter' – intent to deceive, manipulate, or defraud").

[4] Rule 9(b) provides that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." FED. R. CIV. PROC. 9(b).

omitted). *See Ross v. Bolton*, 904 F.2d 819, 823 (2d Cir. 1990) (explaining that "[w]hen fraud is asserted, the general rule [that pleadings are to be construed in the light most favorable to the pleader and accepted as true] is simply applied in light of Rule 9(b)'s particularity requirements"). Accordingly, plaintiffs alleging fraud-based claims were required to "allege facts that give rise to a strong inference of fraudulent intent." *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994) (citations omitted).[5] In order to meet this "strong inference" threshold, the Second Circuit adopted two separate approaches: requiring factual allegations that established both "a motive to commit fraud and an opportunity to do so" or alternatively, "to allege facts constituting circumstantial evidence of either reckless or conscious behavior." *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268-269 (2d Cir. 1993), *cert. denied sub. nom.*, 511 U.S. 1017 (1994).

The Second Circuit's Rule 9(b) pleading requirements sought to balance two competing interests – that of deterring and remedying fraud in the capital markets, with the accompanying recognition "that victims of fraud often are unable to detail their allegations until they have had some opportunity to conduct discovery," *In re Time Warner*, 9

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[5] Some Courts of Appeals announced similar constructions of Rule 9(b). *See, e.g., Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994) ("To plead scienter adequately, a plaintiff must set forth specific facts that support an inference of fraud") (citations omitted); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991) (plaintiff must state "factual allegations that would support a reasonable inference that adverse circumstances existed at the time of the offering, and were known and deliberately or recklessly disregarded by defendants"); *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1127 (7th Cir. 1990), *cert. denied*, 499 U.S. 923 (1991) (complaint alleging fraud "must still afford a basis for believing that plaintiffs could prove scienter"). Other Courts of Appeals, most notably the Ninth Circuit, took a more lenient approach to allegations of fraudulent conduct. *See In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1545-47 (9th Cir. 1994) (*en banc*) (rejecting the Second Circuit's construction and concluding "that plaintiffs may aver scienter generally, just as the rule states – that is, simply by saying that scienter existed").

F.3d at 263, versus the interest in "deterring the use of the litigation process as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs that frequently ensue once a complaint survives dismissal." *Id.* Section 21D(b)(2) sought to balance similar interests. *See* H.R. CONF. REP. at 31 ("Private securities litigation" assists the recovery of defrauded investors' losses and "help[s] to deter wrongdoing," but "abuse of the discovery process . . . impose[s] costs so burdensome that it is often economical for the [defendant] to settle"). But while Rule 9(b) was tempered by the "short and plain" pleading requirement of Rule 8(a)(2),[6] and arguably favored a plaintiff alleging securities fraud, Section 21D(b)(2), when considered together with Section 21D(b)(3)'s discovery stay "during the pendency of any motion to dismiss," 15 U.S.C. § 78u-4(b)(3), decisively tilts the balance in favor of corporate defendants. *See Dabit*, 126 S. Ct. at 1511 ("The effort to deter or at least quickly dispose of those suits whose nuisance value outweighs their merits placed special burdens on plaintiffs seeking to bring federal securities fraud class actions").

1. The PSLRA Does Not Preclude Consideration Of Allegations That Give Rise To A Strong Inference Of Scienter.

Construction of a statute begins with the language of the statute itself. *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 450 (2002); *Ernst*, 425 U.S. at 197. If the language of the statute is plain and its meaning sufficiently clear, there is no need to resort to legislative history.

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[6] Rule 8(a) provides that "[a] pleading which sets forth a claim for relief . . . shall contain . . . (2) a short and plain statement of the claim showing that the pleader is entitled to relief . . . " FED. R. CIV. PROC. 8(a). "This simplified notice pleading standard relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious claims." *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512 (2002).

Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 254 (1992).[7]

Here, Section 21D(b)(2) requires a securities fraud complaint to set forth specific "facts giving rise to a strong inference" of scienter. 15 U.S.C. § 78u-4(b)(2). However, this provision "neither mandated nor prohibited *any* particular method of establishing a strong inference of scienter." *Nathenson*, 267 F.3d at 411 (citing *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195 (1st Cir. 1999)) (emphasis in original). Accordingly, a majority of Courts of Appeals have concluded that the PSLRA does *not* prevent the consideration of any allegations that give rise to a strong inference of scienter, including those allegations recognized by pre-PSLRA Second Circuit precedent that infer both a motive to commit fraud and an opportunity to do so. *See, e.g., In re Advanta Corp.*, 180 F.3d at 534 (the "use of the Second Circuit's language compels the conclusion that the [PSLRA] establishes a pleading standard approximately equal in stringency to that of the Second Circuit"); *Novak v. Kasaks*, 216 F.3d 300, 310 (2d Cir.), *cert. denied*, 531 U.S. 1012 (2000) (concluding "that the PSLRA effectively raised the nationwide pleading standard to that previously existing in this circuit and no higher," but that "Congress's failure to include language

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[7] Even if Section 21D(b)(2) were to be deemed ambiguous, the legislative history would be of little assistance. It has been routinely criticized as "conflicting and inconclusive," *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345 (4th Cir. 2003), "ambiguous," *In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 552 n.10 (6th Cir. 1999), and as reflecting "conflicting expressions of legislative intent." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 533 (3d Cir. 1999). Accordingly, where the legislative history of a statute is contradictory and unenlightening, this Court should hesitate to rely on it. *See, e.g., Exxon Mobil Corp. v. Allapattah Services, Inc.*, 545 U.S. 546, 568 (2005) (observing that "legislative history is itself often murky, ambiguous, and contradictory [and that] [j]udicial investigation of legislative history has a tendency to become . . . an exercise in 'looking over a crowd and picking out your friends' ") (citation omitted); *see also Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994) (court should not "resort to legislative history to cloud a statutory text that is clear").

about motive and opportunity suggests that we need not be wedded to these concepts in articulating the prevailing standard"); *In re K-Tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 894 (8th Cir. 2002) (allegations of "unusual or heightened motive" may be "particularly important to establishing scienter").[8] Thus, if Section 21D(b)(2) at least equals the pleading level formerly imposed only in the Second Circuit, *see, e.g.*, *Nathenson*, 267 F.3d at 412, all factual allegations of a complaint that may give rise to a strong inference of scienter should be considered by a district court on a motion to dismiss.[9]

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[8] The Courts of Appeals seemingly disagree about whether allegations of motive and opportunity, standing alone, can support a strong inference of scienter. The Second and Third Circuits have held that such allegations may be sufficient, *see, e.g.*, *Novak*, 216 F.3d at 311; *In re Advanta Corp.*, 180 F.3d at 534-535; *Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 537-538 (2d Cir. 1999), the Ninth Circuit has categorically rejected them, *see In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999), and the remaining Circuits have held that such allegations may be independently insufficient, but should be considered along with any other allegations (*i.e.*, among the "totality of facts and pleadings") supporting scienter. *See, e.g.*, *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1285-1287 (11th Cir. 1999); *Greebel*, 194 F.3d at 188; *Helwig*, 251 F.3d at 550; *Nathenson*, 267 F.3d at 410-411; *Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 660 (8th Cir. 2001); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1261-1262 (10th Cir. 2001); *Ottmann*, 353 F.3d at 345-346. The Ninth Circuit initially concluded that Section 21D(b)(2) required "deliberate recklessness," *see In re Silicon Graphics*, 183 F.3d at 974, which other courts have described as "an attempt to import into the law a new and uncertain super-recklessness." *Bryant*, 187 F.3d at 1284 n.21. However, commentators have suggested that, in application, the *Silicon Graphics*' "deliberate recklessness" is more akin to the recklessness standard used in other Circuits. *See* Ann Morales Olazabal, *The Search For "Middle Ground": Towards A Harmonized Interpretation Of The Private Securities Litigation Reform Act's New Pleading Standard*, 6 STAN. J.L. BUS. & FIN. 153, 163 (2001) ("[T]here is no reason to believe that the Ninth Circuit's 'deliberate recklessness' is any different from [standards of recklessness required in other Circuits] . . . ").

[9] It is noteworthy that the *amicus curiae* brief filed in this appeal by the United States, through the Department of Justice and the SEC (collectively, the "SEC *Amicus* Br.") departs markedly from over 40

(Continued on following page)

2. The Text Of Section 21D(b)(2) Does Not Alter The Determination Of The Sufficiency Of A Complaint's Allegations On A Motion To Dismiss.

The function of a district court on a motion to dismiss "is not to weigh potential evidence . . . , but to assess whether the plaintiff's complaint alone is legally sufficient . . . " *Pirraglia*, 339 F.3d at 1187 (citation and internal quotations omitted). This is a well-recognized precept. *See, e.g., Global Network Comm., Inc. v. City of New York*, 458 F.3d 150, 155 (2d Cir. 2006) (Rule 12(b)(6) "assesses the legal feasibility of the complaint, but does not weigh the evidence that might be offered to support it"); *Westside Mothers v. Olszewski*, 454 F.3d 532, 537-538 (6th Cir. 2006)

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years of SEC arguments supporting full protection of investors. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 732 (1975) (noting 1957 and 1959 legislative attempts by the SEC to expand the "in connection with" language of Section 10(b) to encompass "*any attempt* to purchase or sell any security") (emphasis added); *Ernst*, 425 U.S. at 197-198 & n.18 (noting SEC's argument that language of Section 10(b) is not limited to "knowing or intentional practices," but may include liability for negligent violations of Rule 10b-5). For example, in an *amicus* brief filed in connection with *Greebel*, 194 F.3d 185, the SEC unequivocally advocated that the PSLRA "adopts the Second Circuit standard for pleading scienter in a private action," *see* SEC *amicus* br., 1999 WL 33911562 (1st Cir. May, 1999), at *1, and stated that the SEC had taken the same position in *amicus curiae* briefs filed in five other pending appeals, including the Second, Sixth, and Eleventh Circuits. *Id.*, at *1 n.1. In the *amicus curiae* brief filed in connection with *In re K-Tel Int'l*, 300 F.3d 881, the SEC argued for a presumption that Congress intended to adopt the Second Circuit's "strong inference" standard. *See* SEC *amicus* br., 2000 WL 35483737, at *12 (8th Cir. Nov. 15, 2000). These arguments stand in stark contrast to the position the SEC takes here. For instance, the SEC argues in this appeal that Congress merely "built upon," rather than adopted, the Second Circuit's precedent, and that where competing inferences are presented, the district court should weigh them and absolve a corporate defendant if "there is a substantial possibility that the defendant acted without scienter." *See* SEC *Amicus* Br. at 18, 24-25. Given the radical departure from previous positions, it is questionable whether the SEC's position should be afforded its customary deference.

(function on a motion to dismiss "is not to weigh the evidence or assess the credibility of witnesses, . . . but rather to examine the complaint and determine whether the plaintiff has pleaded a cognizable claim, . . . "); *see generally*, 5B Charles Alan Wright & Arthur Miller, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 1356 (3d ed. 2004) (a motion to dismiss "is not a procedure for resolving a contest between the parties about the facts or the substantive merits of the plaintiff's case"). Nevertheless, some Courts of Appeals have seemingly determined that weighing of inferences is appropriate at the motion to dismiss stage. *See Helwig*, 251 F.3d at 553 (on motion to dismiss securities complaint, "plaintiffs are entitled only to the most plausible of competing inferences"); *cf.*, *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) ("When determining whether plaintiffs have shown a strong inference of scienter, the court must consider *all* reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs") (emphasis in original). *See generally*, Rick M. Simmons, *Reconciling Pleading Standards Under Pirraglia: The Private Litigation Reform Act v. Federal Rule of Civil Procedure 12(b)(6)*, 81 DENV. U.L. REV. 665, 673-678 (2004) (survey of the differing approaches of Courts of Appeals to weighing competing inferences in securities fraud complaints).

Going beyond even the weighing of competing inferences, Petitioners argue that a "strong inference" of scienter only exists where "the facts cogently demonstrate a promising and substantial claim on the merits that meaningfully tends to exclude alternative innocent explanations." Pet. Br. at 25-26, 34 n.15. Not surprisingly, Petitioners do not rely on ***any*** PSLRA decisions for such a sweeping proposition but, rather, cite *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). Pet. Br. at 26 n.13, 30. However, Petitioners' attempts to equate a summary judgment decision in an antitrust action, issued after years of discovery, with the manner in which a securities fraud complaint should be evaluated on a motion to dismiss, are without merit. First and most

obvious, a summary judgment standard has little application to a motion to dismiss, particularly where, as here, discovery is largely prohibited. *See, e.g., Global Network*, 458 F.3d at 155 ("The streamlined testing of the substantive merits, on the other hand, is more appropriately reserved for the summary judgment procedure, governed by Rule 56, where both parties may 'conduct appropriate discovery and submit the additional supporting material contemplated by' that rule.") (citation omitted). Second, although *Matsushita* warned of the cost that "mistaken inferences" may have on legitimate competition, *id.*, 475 U.S. at 594, no such concern faces Petitioners and their *amici*. Pursuant to the PSLRA, Petitioners and their *amici* have already received the functional equivalent of the narrowed permissible inferences recognized in *Matsushita*.[10] Third, decisions of this Court subsequent to *Matsushita* have emphasized that it "did not introduce a special burden on plaintiffs facing summary judgment in antitrust cases," but "demands only that the nonmoving party's inferences be reasonable in order to reach the jury, a requirement that was not invented, but merely articulated, in that decision." *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 468-469 (1992) (footnote omitted). Thus, *Matsushita*'s applicability is narrowly limited to an antitrust plaintiff's burden in

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[10] As discussed below, securities fraud litigation is vastly different now than prior to the enactment of the PSLRA. Even apart from the innovations of the PSLRA, such as the lead plaintiff requirements, 15 U.S.C. § 78u-4(a)(3), there are a whole panoply of devices under the Federal Rules of Civil Procedure, such as presumptive limits on the length of time of depositions, *see* FED. R. CIV. PROC. 30(d)(2), and immediate (albeit discretionary) appeal of class certification decisions, *see* FED. R. CIV. PROC. 23(f), that curtail the supposed abuses attendant with private securities litigation. Therefore, references by Petitioners and their *amici* to "fishing expeditions" and "blackmail settlements" must be viewed in the context of ***present day*** rules of procedure, and the source of these contentions must be taken into account. *See, e.g., Blue Chip Stamps*, 421 U.S. at 740 (recognizing "the common complaint of the many defendants who would prefer avoiding lawsuits entirely to either settling them or trying them").

opposing summary judgment. It has no applicability outside of that narrow area.

But just as there was no language within Section 21D(b)(2) specifying the type of allegations that may be considered to give rise to a strong inference of scienter, so too there is no language requiring a district court to weigh competing inferences on a motion to dismiss. To the contrary, Section 21D(b)(2)'s use of "inference" acknowledges the distinction between pleading scienter on the basis of a complaint and proving scienter after full discovery has taken place (a distinction that Petitioners seek to blur by invoking *Matsushita*). For example, allegations of "motive and opportunity" that may give rise to an inference of scienter are used by courts "to weed out those cases where scienter was plausible from those in which there was no hope of ever proving fraudulent intent." Olazabal, 6 STAN. J.L. BUS. & FIN. at 168 n.78. *See also* Donald C. Langevoort, *Reflections On Scienter (And The Securities Fraud Case Against Martha Stewart That Never Happened)*, 10 LEWIS & CLARK L. REV. 1, 7 (2006) ("The pleading requirement is about whether plaintiffs get to go to discovery, where solid evidence about awareness or appreciation can be elicited through document production and depositions. Allegations of motive are made important because they help distinguish between strong and weak cases at that early stage, before the pressure to settle becomes overwhelming"). This winnowing function explains courts' conclusions that, even after the PSLRA, "[i]nferences must be reasonable and strong – but not irrefutable." *Helwig*, 251 F.3d at 553; *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 78 (1st Cir. 2002) ("The plaintiff must also show that the inferences of scienter are both reasonable and strong") (citations and internal quotations omitted).

For these reasons, it is clear that Section 21D(b)(2) does not alter the traditional standard used to judge motions to dismiss. *See Aldridge*, 284 F.3d at 78 ("Even under the PSLRA, the district court, on a motion to dismiss, must draw all reasonable inferences from the

particular allegations in the plaintiff's favor, while at the same time requiring the plaintiff to show a strong inference of scienter"); *Helwig*, 251 F.3d at 553 ("Plaintiffs need not foreclose all other characterizations of fact, as the task of weighing contrary accounts is reserved for the fact finder"); *but see id.* at 553 ("[p]laintiffs are entitled only to the most plausible of competing inferences"); *see also JP Morgan Chase Bank v. Winnick*, 406 F. Supp. 2d 247, 250 n.2 (S.D.N.Y. 2005) (finding "no contradiction between permitting all reasonable inferences to be drawn in favor of the plaintiff, and yet requiring that these inferences of scienter be sufficiently strong to satisfy Rule 9(b)"); *In re Alstom SA Sec. Litig.*, 454 F. Supp. 2d 187, 207 n.16 (S.D.N.Y. 2006) (same, construing Section 21D(b)(2)). Thus, the court below was correct in concluding that, once a "strong inference" of scienter is presented, Section 21D(b)(2) of the PSLRA requires nothing more. *See Tellabs*, 437 F.3d at 602; *Pirraglia*, 339 F.3d at 1188 ("If a plaintiff pleads facts with particularity that, in the overall context of the pleadings, including potentially negative inferences, give rise to a strong inference of scienter, the scienter requirement of the [PSLRA] is satisfied").

3. Weighing "Innocent Inferences" Against "Culpable Inferences" On A Motion To Dismiss Will Turn Securities Fraud Actions Into Mini-Trials On The Pleadings.

If this Court adopts the arguments of Petitioners and their *amici* and requires courts to engage in the delicate and factually based weighing of "innocent inferences" against "culpable inferences," it will curtail plaintiff's rights by permitting defendants to turn the face of a securities fraud complaint into a mini-trial on the merits at the pleading stage, before the plaintiff has the benefit of any formal discovery that is uniquely in the hands of defendants. To prevail at this pleadings "mini-trial," defendants will advance every conceivable self-serving "innocent inference" and seize upon the well-accepted principle that when ruling on a motion to dismiss, a court

may properly consider documents referenced in a complaint though not attached, so long as neither party questions the authenticity of those documents. *See, e.g., Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002) ("court may consider 'documents attached to the complaint as an exhibit or incorporated in it by reference, . . . matters of which judicial notice may be taken, or . . . documents either in plaintiffs' possession or of which plaintiffs had knowledge and relied on in bringing suit'") (citation omitted); *Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498-99 (5th Cir. 2000) (court may consider materials "referred to in the plaintiff's complaint and . . . central to her claim") (quoting *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429, 431 (7th Cir. 1993)); *Parrino v. FHP, Inc.*, 146 F.3d 699, 705-06 (9th Cir.), *cert. denied*, 525 U.S. 1001 (1998) (on motion to dismiss, court may consider documents not attached to complaint yet crucial to the claim). This includes documents that are integral to a plaintiff's claim but not explicitly incorporated in the complaint. *Parrino*, 146 F.3d at 706. A district court may also consider matters that are properly the subject of judicial notice when ruling upon a motion to dismiss without converting the motion into one for summary judgment. *Barron v. Reich*, 13 F.3d 1370, 1377 (9th Cir. 1994).[11]

Accordingly, culpable corporate defendants who are engaged in misconduct will have an incentive to publish information in the midst of the fraud that can later be used to create an "innocent inference" from the face of the pleadings when faced with a securities fraud complaint. For example, a corporate defendant engaged in overstating financial results could publish revised future sales or

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[11] For example, information obtained from a website, where neither party questions the authenticity of the site or the document, meets the definition of Federal Rule of Evidence 201 and is a proper subject of judicial notice. *Pollstar v. Gigmania Ltd.*, 170 F. Supp. 2d 974, 978 (E.D. Cal. 2000) (taking judicial notice of website printout referenced in complaint when ruling on motion to dismiss).

earnings projections, or make statements on its website, that would lessen investor expectations as the fraud is tapered off and then rely on the downward revision to create an innocent inference if the fraud is ever revealed. Although a plaintiff may allege particularized facts that give rise to a strong inference of scienter, such as statements from confidential sources, under Petitioners' proposed standard, the district court would nonetheless be required to offset the strong inference of scienter with innocent inferences created from the downward revision. In the same vein, a defendant who knowingly overstates revenue and income through fraudulent vendor credits could then commission a study of vendor credits or overhaul the vendor credit system and later contend that such actions are inconsistent with culpable conduct, when in fact the study or overhauled system concealed the fraud and its impact on the issuer's financial results.

Consideration of such self-serving actions is properly reserved for a motion for summary judgment or for trial, when a jury can properly and thoroughly consider the weight of the evidence and the credibility of witnesses, and after plaintiffs have had an opportunity for formal discovery to fully explore events surrounding the supposed innocent inference. To offset a strong inference of scienter with any innocent inferences that a defendant may be able to construct at the pleadings stage would result in the dismissal of otherwise meritorious claims and would be contrary to the stated intention of the PSLRA.

4. Weighing "Innocent Inferences" Against "Culpable Inferences" On A Motion To Dismiss Improperly Invades The Province Of The Jury.

Scienter is a question of fact and is normally to be decided by a jury. *See, e.g., In re Cerner Corp. Sec. Litig.*, 425 F.3d 1079, 1084-1085 (8th Cir. 2005); *In re K-Tel Int'l*, 300 F.3d at 894; *Press*, 166 F.3d at 538. Thus, Section 21D(b)(2)'s use of the term "inference" is significant. An

inference is merely a conclusion or deduction the fact-finder may in its discretion reach, but is not required to draw as a matter of law. *See* Michael H. Graham, HANDBOOK OF FEDERAL EVIDENCE § 301:7 (6th ed. 2006); *see also Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1105 (10th Cir. 2003) ("An inference is a logical conclusion drawn from the facts") (citation omitted).[12] This meaning is also consistent with decisions pre-dating the PSLRA from the Second Circuit and elsewhere acknowledging that proof of scienter is usually a matter of inferences drawn from circumstantial evidence. *See, e.g., Wechsler v. Steinberg*, 733 F.2d 1054, 1058-1059 (2d Cir. 1984); *State of Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 695 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981). This Court has likewise recognized that "the *proof* of scienter required in fraud cases is often a matter of inference from circumstantial evidence." *See Herman & MacLean*, 459 U.S. at 390 n.30 (emphasis added). *See also Greebel*, 194 F.3d at 195 (the PSLRA "plainly contemplated that scienter could be *proven* by inference, thus acknowledging the role of indirect and circumstantial evidence") (emphasis added).

The court below was properly hesitant to interpret Section 21D(b)(2)'s "strong inference" language as allowing plaintiffs only "the most plausible of competing inferences" because it recognized that such a standard could be considered "a usurpation of the jury's role." *Tellabs*, 437 F.3d at 602.[13] Rather than potentially intrude on a jury

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[12] In this respect, an inference is distinguishable from a presumption, which is a legally compelled conclusion. *See* FED. R. EVID. 301. Congress understood the difference between the two terms, as demonstrated by the use of "presumption" in the PSLRA's "lead plaintiff" provisions. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii).

[13] Indeed, this concern was initially raised by a different panel of the Sixth Circuit from the one that first announced this controversial standard. *See City of Monroe Employees Retirement System v. Bridgestone Corp.*, 399 F.3d 651, 683 n.25 (6th Cir. 2005) (suggesting that "a Seventh Amendment Problem" may be presented "where a juror could conclude that the facts pleaded showed scienter, but that conclusion would not be the most plausible of competing inferences"); *see also*

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function, the *Tellabs* court correctly concluded that, once a strong inference of scienter was raised by the plaintiff's complaint, it would survive a motion to dismiss as long as "it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." *Id.*

Although Petitioners and their *amici* (including the SEC) dismiss this concern, the ***practical*** effect of the standard that they seek to have this Court impose on securities fraud complaints invites an intrusion on the role of a jury, and simply because the court below raised the issue *sua sponte* is no reason for this Court to ignore the import of what it is being asked to do. Inviting a district court to weigh competing inferences clearly usurps a role traditionally assigned to a jury. *See, e.g., Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 700-701 (1962), *superceded by statute on other grounds*, 15 U.S.C. § 6a (a jury "'weighs the contradictory evidence and inferences' and draws 'the ultimate conclusion as to the facts'") (citation omitted); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986) ("Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge, . . . ").

Decades ago a member of this Court voiced concern over the "gradual process of judicial erosion which in one hundred fifty years has slowly worn away a major portion of the essential guarantee of the Seventh Amendment." *Galloway v. United States*, 319 U.S. 372, 397 (1943) (Black, J., *dissenting*). More recently, commentators have noted the increase with which fundamental jury functions, such as "commonsense determinations about human behavior, reasonableness, and state of mind based on objective standards, . . . have been taken away from juries by pretrial disposition . . . . " Arthur R. Miller, *The Pretrial Rush To Judgment: Are The "Litigation Explosion," "Liability*

Helwig, 251 F.3d at 553 (announcing the "most plausible of competing inferences" standard).

Crisis," And Efficiency Cliches Eroding Our Day In Court And Jury Trial Commitments?, 78 N.Y.U. L. REV. 982, 1134 (2003). Yet, as noted by then-Associate Justice Rehnquist in discussing the historical importance of the right to trial by jury, "[t]hose who passionately advocated the right to a civil jury trial did not do so because . . . [of] a belief that the use of juries would lead to more efficient judicial administration" but, rather, it "was important to the founders because juries represent the layman's common sense, the 'passional elements in our nature,' and thus keep the administration of law in accord with the wishes and feelings of the community." *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 343-344 (1979) (Rehnquist, J., *dissenting*).

This Court has recognized that "[m]aintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care." *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 501 (1959); *see also Jacob v. City of New York*, 315 U.S. 752, 752 (1942) (recognizing right to a jury trial in civil cases as "a basic and fundamental feature of our system of federal jurisprudence" that "should be jealously guarded by the courts"). This Court has likewise deemed it a "cardinal principle" of statutory construction that where "the validity of an act of the Congress is drawn in question, and . . . a serious doubt of constitutionality is raised," the Court should "first ascertain whether a construction of the statute is fairly possible by which the question may be avoided." *Crowell v. Benson*, 285 U.S. 22, 62 (1932); *see also Boos v. Barry*, 485 U.S. 312, 331 (1988); *New York v. Ferber*, 458 U.S. 747, 769, n.24 (1982). In this instance, consistent with these pronouncements, the Court should not adopt a construction of Section 21D(b)(2)'s "strong inference" requirement that would permit the weighing of competing inferences on a motion to dismiss.

B. PRIVATE ACTIONS SERVE AN ESSENTIAL FUNCTION IN THE SECURITIES MARKETPLACE TO DETER FRAUDULENT MISCONDUCT AND COMPENSATE HARMED INVESTORS.

The PSLRA was intended to address "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Dabit*, 126 S. Ct. at 1510. However, there has been continuing debate regarding the validity of these "perceived abuses." *See, e.g.*, Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. CINN. L. REV. 95, 97-98 (2004) (explaining that a study used by backers of the PSLRA to suggest that securities class action settlements amounted to "a trivial percentage of the potential damages" actually confused "investor losses with recoverable damages"); Leonard B. Simon & William S. Dato, *Legislating on a False Foundation: The Erroneous Academic Underpinnings of the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 959, 962, 972 (1996) (explaining that, because a study relied upon by proponents of the PSLRA was "fundamentally flawed," the PSLRA "cannot solve the 'problem' identified by [the study], because the 'problem' [] described does not exist;" noting, for example, that "limited insurance coverage and defendant's inability to satisfy a judgment" are "uncontrolled-for factors" that can cause "a strong case on the merits [to settle] for about the same amount as a weaker case without similar problems"); John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAWYER 335, 340 (1996) (noting that although "witnesses gave anecdotal evidence of widespread abuses in the private litigation system, . . . the empirical evidence was inconclusive") (footnotes omitted). Indeed, the supposed ineffectiveness of federal courts to curtail frivolous lawsuits through the use of Federal Rule of Civil Procedure 9(b) – one of the main objections of the proponents of the PSLRA – was not, even prior to the debate over the PSLRA, universally accepted. *See, e.g.*, Jeff Sovern, *Reconsidering Federal*

Civil Rule 9(b): Do We Need Particularized Pleading Requirements In Fraud Cases, 104 F.R.D. 143, 154 (1985) (commenting that "Rule 9(b) may permit a guilty defendant to hide behind insufficient pleadings to prevent the truth from emerging"); Note, *Pleading Securities Fraud Claims With Particularity Under Rule 9(b)*, 97 HARV. L. REV. 1432, 1432 (1984) (observing that "defendants in securities fraud actions have been winning motions to dismiss under Rule 9(b) with increasing frequency").

It is recognized, however, that the PSLRA was not intended to eliminate meritorious securities fraud complaints. *See, e.g., Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1235 (9th Cir. 2004) ("The PSLRA was designed to eliminate frivolous actions, but not actions of substance"); *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 354 (5th Cir. 2002) ("[The PSLRA] was not enacted to raise the pleading burdens under Rule 9(b) and section 78u-4(b)(1) to such a level that facially valid claims, which are not brought for nuisance value or as leverage to obtain a favorable or inflated settlement, must be routinely dismissed on Rule 9(b) and 12(b)(6) motions. . . . [T]he PSLRA may have changed federal securities law; it did not eliminate it") (citations omitted); S. REP., at 6 (PSLRA was "intended to encourage plaintiffs' lawyers to pursue valid claims for securities fraud . . . "). It is also clear, despite the invective of Petitioners and their *amici*, that the PSLRA is achieving its goals of preventing the filing of "strike suits" and eliminating lawyer driven litigation.[14] *See, e.g.*, Stephen

[14] The *amicus curiae* brief of The Securities Industry and Financial Markets Association and The Chamber of Commerce of the United States of America ("SIFMA/Chamber of Commerce") in support of Petitioners is disingenuous. For example, SIFMA/Chamber of Commerce note with alarm that "seven of the ten largest [securities fraud class action] settlements ever" occurred within the last two years, *see* SIFMA/Chamber of Commerce *amicus* br. at 8, but fail to appreciate that these settlements, such as WorldCom, involved massive, egregious frauds in which billions of dollars of investor capital was eliminated. Moreover, this observation does not put the fraudulent conduct in

(Continued on following page)

J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes After The First Decade After The PSLRA*, 106 COLUM. L. REV. 1489, 1501, 1503-1506 (2006) (citing a study indicating that, with respect to companies with highly volatile stocks, the PSLRA has discouraged "frivolous litigation, but not meritorious litigation," and noting, *inter alia*, that "[t]he participation rate of institutional investors . . . has grown significantly since 2000," with "[a]necdotal evidence" indicating that institutional investors have been able to "develop more effective case supervision and fee agreements").

1. The PSLRA's Lead Plaintiff Provision Has Curbed Supposed Lawyer-Driven Litigation.

Petitioners and their *amici* ignore that the "lead plaintiff" provision, 15 U.S.C. § 78u-4(a)(3)(B), is the PSLRA's principal prophylactic measure to deter lawyer driven litigation and prevent the filing of unmeritorious "strike suits." *See, e.g., Hevesi v. Citigroup Inc.*, 366 F.3d 70, 82 n.13 (2d Cir. 2004) ("lead plaintiff" provision was intended to "empower investors so that they – not their lawyers – exercise primary control over private securities litigation") (quoting S. REP., at 4); *In re Cendant Corp. Sec. Litig.*, 404 F.3d 173, 180 (3d Cir. 2005) (PSLRA created "a paradigm in which the plaintiff with the largest stake in

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context, since most of the actions arose prior to the passage of the Sarbanes-Oxley Act of 2002, PUB. L. NO. 107-204, 116 Stat. 745 (codified in scattered sections of 15 & 18 U.S.C.). Finally, SIFMA/Chamber of Commerce ignore that larger settlements may be the result of the PSLRA's impact of allowing only potentially meritorious claims to proceed past the motion to dismiss. In addition, notably absent from the SIFMA/Chamber of Commerce brief is the "flip-side" of the PSLRA – the sharp decrease in the number of securities fraud class actions being filed and that the dismissal rate of securities fraud complaints has nearly doubled since passage of the PSLRA. *See* Todd Foster, Ronald I. Miller, Ph.D. & Stephanie Plancich, Ph.D., *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar*, NERA ECONOMIC CONSULTING STUDY (Jan. 2007) ("*Recent Trends*"), at 2-4 (available at www.nera.com/Publication.asp?p_ID=3028).

the case, usually a large and sophisticated institution, is accorded the status of lead plaintiff and assigned the right to appoint and duty to monitor lead counsel for the class"). This provision favors the appointment of large and sophisticated institutional investors who have the ability to actively participate in the class action and monitor the progress of class counsel, thus reducing agency costs that may arise when class counsel's interests diverge from those of the shareholders. *See, e.g.*, Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 708 (2002) (noting that institutions serving as lead plaintiff "appear acutely sensitive to agency issues and readily defend their chosen fee structures in terms of minimizing agency costs") (footnote omitted). As a result, the control of securities class action litigation has been significantly transferred from ostensibly disinterested individuals who may have a diminutive financial interest in the case and only minimal oversight of class counsel, to large, sophisticated institutional investors who have a much greater financial interest in the outcome of the litigation and who have the ability and means to select competent class counsel. *See, e.g.*, Laura E. Simmons & Ellen M. Ryan, *Post-Reform Act Securities Settlements: 2005 Review and Analysis*, CORNERSTONE RESEARCH ESSAY (2006) ("*Post-Reform Securities Settlements*"), at 9 (available at http://tinyurl.com/ywhf7w) (noting the increase in the percentage of institutional investors serving as lead plaintiffs since passage of the PSLRA); Choi & Thompson, 106 COLUM. L. REV. at 1505 (citing studies indicating that "cases with institutional investors as lead plaintiffs have higher settlement amounts than other class action securities fraud cases") (footnote omitted).

2. The PSLRA's Discovery Stay, Together With Amendments To The Federal Rules Of Civil Procedure, Has Severely Diminished "Strike Suits."

This Court has long identified so-called "strike suits" as a source of concern. *See, e.g.*, *Cohen v. Beneficial Loan*

Corp., 337 U.S. 541, 548 (1949) (describing "strike suits" as actions "brought not to redress real wrongs, but to realize upon their nuisance value"). Although initially directed toward shareholder derivative actions, the term "strike suit" was later used to encompass securities fraud class actions. *See* Choi & Thompson, 106 COLUM. L. REV. at 1492-93. The legislative history of the PSLRA is clear in this respect – part of the impetus for the legislation's passage was the ancedotal accounts of the PSLRA's corporate proponents who claimed that the unrestrained cost of discovery often forced corporate defendants to settle "strike suits" in order to avoid the cost of litigation. *See* S. REP., at 4, 9.

The PSLRA's "approach to pretrial discovery [is] akin to a sledgehammer." Seligman, 73 U. CINN. L. REV. at 117. Section 21D(b)(3)(B) mandates a stay of discovery "during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party." 15 U.S.C. § 78u-4(b)(3)(B). The discovery stay is intended to prevent perceived pre-PSLRA abusive discovery tactics by directing district courts to first determine the legal sufficiency of the claims in securities fraud class actions before permitting any discovery to be served. *See Lander v. Hartford Life & Annuity Insurance Co.*, 251 F.3d 101, 107 (2d Cir. 2001).

When considered with changes to the Federal Rules of Civil Procedure in the years following passage of the PSLRA, it is apparent that the perception of securities fraud class actions as a vehicle for unfettered discovery is now out-dated. In 2000, amendments to Rule 26 narrowed the scope of discovery. Although discovery had been available, since adoption of the Federal Rules of Civil Procedure in 1938, for anything "relevant to the subject matter of the action," that scope was curtailed to areas "relevant to a claim or defense in the action." FED. R. CIV. PROC. 26(b)(1). This amendment was intended to "signal[]" district courts to exercise their "authority to confine discovery" and to "regulat[e] the breath of sweeping or contentious discovery." *See* FED. R. CIV. PROC. 26, Advisory

Committee Notes to 2000 amendments. The Federal Rules of Civil Procedure now impose presumptive limits on both the number of depositions and their length of time. *See* FED. R. CIV. PROC. 30(a)(2)(A), (d)(2). When considered with the PSLRA's discovery stay, it is clear that assuming *arguendo* that discovery costs alone ever prompted settlement, that leverage has dissipated, if not disappeared entirely.

3. Securities Class Action Filings Are At An All-Time Low And Dismissal Rates Are At An All-Time High Since Passage Of The PSLRA.

Securities fraud class action filings have fallen to an all-time low and dismissal rates are at an all-time high since enactment of the PSLRA, two facts that militate against a heightened pleading standard that would require a district court, having found a strong inference of scienter, to offset that determination with supposed "innocent inferences" to be interpreted from the pleadings or extracted from documents that defendants will invariably append, when possible, to Rule 12(b)(6) motions to dismiss that are filed in virtually every federal securities class action.

According to NERA Economic Consulting, the drop-off in filings began in 2005 and accelerated through 2006. *See Recent Trends* at 2. The 129 securities fraud class actions filed in 2006 (of which 22 were novel options back-dating cases) was well below the annual post-PSLRA average of 239 filings annually. *See id.* at 1-2, 4 (observing that "[a]nnual 2006 federal filings were at the lowest level since 1996 – a year that was itself unusually low because many filings were moved to state courts in an attempt to bypass the restrictions imposed by the [PSLRA]"). The number of 2006 filings, through December 15, 2006, represents a 36% drop from 2005 levels, and a 44% decline from the post-PSLRA average. *Id.*

While securities class action filings are markedly down since passage of the PSLRA, dismissal rates of securities class actions have risen measurably. Between

1991 and 1995, dismissals accounted for just under 20% of dispositions of securities fraud class actions. *See id.* at 4. However, between 2000 and 2004, that rate increased to 38.2%. *See id.* It is apparent from these figures that Section 21D(b)(2)'s heightened pleading requirement, particularly when combined with the PSLRA's discovery stay, is having its intended effect.[15]

V. CONCLUSION

NCPERS and NASCAT submit that the Seventh Circuit correctly refused to endorse the weighing of competing inferences at the motion to dismiss stage. Neither the text of Section 21D(b)(2) nor public policy requires such a drastic change in the traditional deference accorded to a plaintiff's complaint. Moreover, since empirical evidence indicates that the PSLRA is having its intended effect, the position of Petitioners and their *amici* is a solution in search of a problem. For the reasons stated above, there is no reason to make a defrauded investor's task of deterring future fraud and obtaining compensation more difficult than it is currently.

Dated: March 8, 2007

Respectfully submitted,

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[15] Moreover, as courts and commentators had predicted, *see, e.g.*, *Lander*, 251 F.3d at 107, the PSLRA may have discouraged meritorious, albeit smaller, private securities actions. The Cornerstone Research study cited by SIFMA/Chamber of Commerce indicates a downward trend of smaller settlements (less than $10 million) as a percentage of all securities fraud class action settlements. *See Post-Reform Securities Settlements* at 3.

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